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C O N F I D E N T I A L SECTION 01 OF 03 PRAGUE 001201

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TAGS: [EFIN](#) [ECON](#) [PGOV](#) [EZ](#)
SUBJECT: 2008 CZECH BUDGET: THE ANOREXIC BEAR

REF: A. PRAGUE 973

[1](#)B. 06 PRAGUE 1173

Classified By: Political-Economic Counselor Mike Dodman for reasons 1.4
(b) + (d)

[1](#)1. (SBU) SUMMARY: The draft 2008 state budget passed the first reading in Parliament on October 23 and final approval is expected in December. The Czech government, in an effort to meet the Maastricht budget deficit ceiling of 3 percent of GDP, has proposed a comparatively lean budget for 2008. For example, the budget sharply reduces the amount of money available for the annual parliamentary ritual of "carving up the bear" -- in American political lexicon, appropriating funding for pork barrel projects. The budget bill is expected to pass relatively intact. The impact of the 2008 budget on the revised Czech euro adoption strategy will be reported septel. END SUMMARY.

BUDGET TRANSPARENCY DEFICIT

[1](#)2. (C) The first reading of the 2008 draft budget began in the Czech Parliament on October 17. The budget will now be discussed in committees, where much of the money reserved for the deputies, earmarks will be allotted in a process fondly referred to as "carving up the bear." The Minister of Finance described this year's "bear" as "anorexic" because the reported amount of CZK 3 billion is about half of last year's "bear." Nevertheless, according to ODS MP Jan Schwippel, a fiscal conservative, this reduced amount does not really reflect the full extent of the subsidies hidden in the budget and funneled to various projects and regions through different mechanisms. In an interesting insight into the murky Czech budgetary politics, Schwippel noted that deputies belonging to the three government coalition parties can generally expect to receive about three times as much earmark funding as opposition deputies. The Czech budget has been frequently criticized as being opaque and not based on any strategic criteria.

NOT MUCH ROOM FOR OPPOSITION OR NEGOTIATION

[1](#)3. (C) In a recent meeting with econoffs, Czech Deputy Finance Minister Eduard Janota expressed confidence that the budget would pass more or less as proposed by the government. However, Janota and others realize that this relatively tight budget will prove more difficult to pass in the closely divided lower chamber, thus they are focused on winning and maintaining the support of the two opposition party defectors, Pohanka and Melcak. Janota explained that there simply is not much room to increase expenditures if the

Czechs want to fulfill their promises to Brussels to meet EU Maastricht deficit criteria. The proposed budget cannot increase expenditures beyond CZK 2 billion from the proposed draft and already, Melcak has asked the government for more money for school teachers; to secure his vote, the government agreed to add CZK 1 billion for teachers' salaries. This will bring the salary increase from 1.5% to 3%, but it is still below the 3.8% inflation projected in 2008 due to VAT and administered price increases.

13. (C) Janota, a career civil servant, described Finance Minister Kalousek as in the top three among the ten Finance Ministers he has served over the span of his career. He described Kalousek as clever, responsible, and decisive. Janota, who had been fired by former Finance Minister Tlustý under the first unconfirmed Topolánek government and re-appointed by Kalousek, noted with delight that he and Minister Kalousek have a true partnership and that they can argue opposing views professionally. Janota confirmed that since the economic reform bill this summer (ref A) mainly tackled the revenue side instead of the more problematic expenditures side, this budget is essential to making real headway on the structural deficit. Looking ahead, he said there is no avoiding serious reform on both healthcare and pensions to meet future deficit targets.

MORE FOR TRANSPORTATION, REGIONAL DEVELOPMENT, MFA

14. (U) The overall parameters for the 2008 state budget are as follows: CZK 1,107 billion in expenditures, CZK 1,037 billion in revenues, resulting in a deficit of CZK 70.8 billion or 2.95% of projected GDP. The following are proposed expenditures by ministry, and nominal change from

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2007 (note that projected 2008 inflation is 3.8%):

- Ministry of Labor budget will increase 1.9% to 434.706 billion
- Ministry of Education budget will DECREASE 2.8% to CZK 118.279 billion
- Ministry of Transportation budget will increase 139.4% to CZK 60.157 billion
- Ministry of the Interior budget will increase 7.1% to CZK 58.165 billion
- Ministry of Defense budget will increase 0.49% to CZK 54.169 billion
- Ministry of Agriculture budget will increase 4.7% to CZK 49.140 billion
- Ministry of Justice budget will increase 10.8% to CZK 22.024 billion
- Ministry of Finance budget will increase 7.3% to CZK 17.346 billion
- Ministry of Regional Development budget will increase 43.9% to CZK 17.290 billion
- Ministry of Industry and Trade budget will DECREASE 15.2% to CZK 13.99 billion
- Ministry of Health budget will increase 14.6% to CZK 10.161 billion
- Ministry of Culture budget will increase 11.8% to CZK 8.844 billion
- Ministry of Foreign Affairs budget will increase 40.6% to CZK 6.783 billion
- Ministry of Environment budget will DECREASE 55.8% to CZK 5.973 billion

15. (U) CZK 20 billion of the Ministry of Transportation's CZK 35 billion budget increase will go toward financing the CZK 88 billion extra-budgetary Transportation Infrastructure Fund. The increase in the Ministry of Regional Development budget is reflective of the strong ODS power base in the regions. Despite general perceptions that the Ministry has been ineffective, especially in the area of securing EU funding, the planned budget increase reflects expectations

that the Ministry will secure CZK 70 billion from the EU in 2008. The MFA budget increase is to cover costs associated with preparations for the six-month Czech EU Presidency starting in January 2009.

LESS FOR ENVIRONMENT & EDUCATION; NOT ENOUGH FOR DEFENSE

16. (SBU) The decrease in the Ministry of Environment budget may seem peculiar at first glance given that over 20% of EU funds available to member states is for the environment. However, most of the EU environmental funds will actually go to the Ministry of Agriculture and the Ministry of Transport. Janota believes the reason the Greens have not objected much to the Environment Ministry's budget cut is because they are content with the passage of the ecological tax by Parliament in August as part of the public finance reform bill, a key plank in their 2006 campaign platform. The decrease in the Ministry of Education budget is expected to be filled by EU funds.

17. (C) Despite the nominal increase in the defense budget, the 2008 figure represents only 1.4%/GDP. During her October 23 meeting with Defense Secretary Gates, Defense Minister Parkanova acknowledged that the Czechs, like most NATO member countries, remained below the 2%/GDP NATO target for defense spending but said she would work toward fulfilling this pledge in the future. According to the Finance Ministry, however, there is no strong base of support -- neither the Parliament nor the public -- for increasing the MOD's budget, due largely to past mismanagement of ministry finances. While some MFA and MOD officials believe that the increasing number of foreign deployments will translate into a higher budget, neither the Defense nor the Finance Ministry seems to have concrete plans or a strategy to reach the NATO budget pledge.

EU AND MINISTRY RESERVE FUNDS

18. (SBU) The proposed budget assumes that the Czech government will draw CZK 76 billion from the possible CZK 100 billion in EU structural funds. However, based on past record, many are skeptical about this assumption. According to Janota, any shortfalls in anticipated EU funding will be covered by each Ministry's reserve fund, the combined total of which stands at CZK 39 billion. Ministry reserve funds are funds left over from previous years which the Ministry gets to keep. The government created these funds to avoid

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the recurring spending-sprees during the final months of the calendar year. Finance Minister Kalousek, however, decided this year that Ministries would be only allowed to keep half of their reserve funds and forced to return the other half to the Ministry of Finance to finance the 2008 budget. The Czech Republic will contribute CZK 30 billion to the EU budget in 2008.

COMMENT

19. (SBU) The period between the first and second reading of the budget bill is usually filled with behind the scenes negotiations over the bear, and other funding that would flow to parliamentarians, districts and priorities. Consequently, the opposition has been relatively silent on the proposed budget since the first reading, although it did challenge the constitutionality of the public finance and tax reform law (ref A) on which the 2008 budget is based. Undoubtedly, the opposition will also raise the decibel level of its complaints about the budget bill as the second reading approaches. Nevertheless, we expect that the budget will

pass intact, given that the government has taken care to ensure that the two CSSD renegades will vote for the bill. Furthermore, even the opposition knows that there simply is not much room for haggling if the Czech Republic is to meet the EU deficit ceiling. The opposition may also prefer to prepare for what is expected to be the next big political clash over the controversial -- but necessary -- healthcare and pension reform bills planned for 2008. Finally, we do not expect a repeat performance from the ODS rebels, who backed former Finance Minister Tlustý's challenge to the reform bill in August. Having lost the August fight, Tlustý has seen his influence within the ODS decline. Schwippel, one of Tlustý's supporters, considers the budget a done deal. Graber